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First National City Bank Monthly Letter

Business and Economic Conditions

New York, August, 1958

General Business Conditions

THE business news has been dominated by a steady flow of reports of growing business strength. Most important indicators show improvement in May and June over the low points reached earlier this year. While it is questionable how much this improvement can be extended during the summer vacation lull, evidence is becoming steadily more impressive that the downtrend has been arrested and that an upturn is in the making.

The crisis in the Middle East, raising the spectre of "another Korea" combined with "another Suez," gave a temporary fillip to prices of commodities important in international trade and caused some restirring of interest in ship chartering. While these fears have not materialized, they have left a legacy of stimulation to inflation psychology and prompted many businessmen to give a second thought to policies of deferred ordering and paring inventories to the bone. It is clear, however, that these developments are not the key to the improvement in business. This was under way well before American troops landed in Lebanon.

The improvement, even in its early stages, has not been confined to a limited group of producers or buyers but has spread through a broad cross-section of the economy. The advances, however, have been quite moderate. While the stock market has continued to boil upward, businessmen have remained cautious in their appraisals of the degree of pickup that lies ahead. Profit margins are narrower and dividend declarations are being studied with more than usual care.

Other, less precise but nonetheless real, causes of anxiety are found in the failure of the Congress to meet decisively needs for labor reform legislation, continuing upward pressure of labor costs, political attacks upon price advances to cover increased costs, the failure to undertake tax reforms, and the swollen federal deficit which carries a threat of still higher taxes as well as generalized inflation.

A stubborn fact overlooked in the political debate is that the rebalancing of the budget under existing tax rates is out of the question unless and until prices are advanced with effects of covering increased labor costs and swelling the tills of taxable business profits.

A Broad Upturn in Production

Industrial activity advanced on a broad front in June. The Federal Reserve production index (seasonally adjusted, 1947-49 = 100) recovered to 130 in June from the April low of 126. Not a single major manufacturing or mining industry for which seasonally adjusted June data were available showed a decline. The increase in steel and automobile output alone accounted for nearly a third of the rise between April and June, but the extent to which the advance was shared by other industries emphasized that this was no fluke of anticipatory inventory building in steel or changing seasonal patterns in autos.

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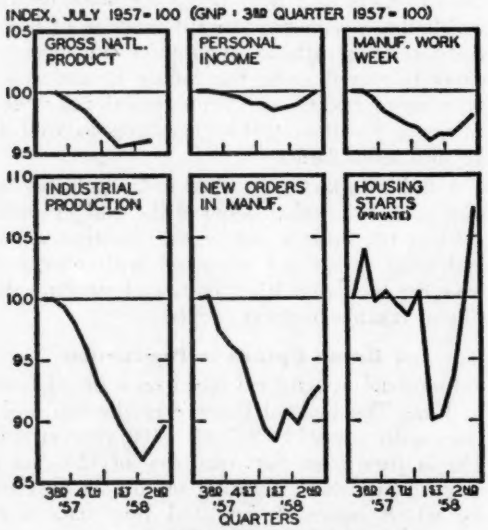
In July, actual output has dropped, as is usual because of vacation shutdowns in numerous industries. Preliminary production reports are insufficient to tell if plant closings this year were more than seasonal, but it is doubtful that the seasonally adjusted indexes advanced much further, if at all, in July.

The steel industry reports that orders and shipments held up better in July than previously anticipated — partly because price increases were deferred until the closing days of the month. Even so, steel output in July averaged about 11 per cent less than the daily rate in June. Passenger car production in July was scheduled at 325,300, a decline of about 8 per cent from the June daily rate, and in August it will drop considerably further as major companies prepare for model changes. In both industries, however, the summer curtailment may be regarded as preparing a firmer base for recovery later in the year.

The accompanying chart shows the extent of recovery in a group of six major economic measures. In order to show the relative decline and recovery more clearly, each series has been expressed as a percentage of its level in July 1957 — the date which the National Bureau of Economic Research has established as the peak of the 1954-57 rise.



Recovery Patterns in Major Indicators
(Seasonally adjusted)

The upturn in industrial production, starting from an April low, was preceded, as in most business cycles, by an improved showing in new orders received by manufacturers and by lengthening of the factory work week. Both of these series hit their low in February and the strength they showed in May and June is a good omen for further improvement in production.

Offsetting Factors in the Recovery

The most significant rise has been that in the gross national product. This series (recently revised) represents the total value of goods and services produced, and because of this broad coverage it reacts only to major movements in the economy. Preliminary estimates for the second quarter of 1958 indicate gross national product recovered to a seasonally adjusted annual rate of $428 billion, up $2.2 billion from the first quarter low, but still about 4 per cent below the peak of $445.6 billion in the third quarter of 1957. A particularly encouraging feature of this upturn is that it occurred without the help of a letup in inventory liquidation. During the second quarter, businessmen continued to let stocks run off at the record rate of $9.5 billion, the same as in the first quarter.

If adjustment were made for higher prices, the moderate rise in gross national product might disappear. But whether output stabilized or increased, it confirmed the expectations of many observers that there was sufficient strength in the rest of the economy to offset the continuing decline in capital outlays. Together, federal, state, and local government spending (up $1.5 billion in the second quarter) and normal growth in consumer demand for nondurable goods and services (up $2.5 billion) more than offset the decline in business investment in plant and equipment (down $0.8 billion) and weakness in consumer "investment" in durable goods and housing (down $1.6 billion).

Once the summer lull is past, indications point to increasing government and consumer spending and a slackening of the decline in investment. A turnaround in residential construction is already foreshadowed by the marked recovery in housing starts and contract awards. This, together with a lessening of the drag of inventory liquidation, could shift the balance decisively on the side of recovery.

Income and Spending Strong

A major force that kept the recession from snowballing was the sustained high level of personal income. From the record seasonally adjusted annual rate of $352 billion in August 1957, the decline at its worst was only $5.7 billion or 1½ per cent. By June 1958, income was back within a shade of its peak and in July it will undoubtedly set a new record as government pay raises become effective.

Although income has been rising since February, the most encouraging aspects are that in

May and June the bulk of the rise was in wages and salaries and that in June unemployment benefits and other transfer payments declined. These developments reflect the rehiring and lengthening of work weeks typical of the early stages of recovery.

Consumer expenditures have been maintained at near-record levels with the help of the high level of income, but the ways in which the consumer spends his money have shifted. Spending for nondurable goods recovered to a new record in the second quarter, and outlays for services never stopped growing all through the downturn. Purchases of durable goods, however, were down 12 per cent from the peak in the third quarter of 1957 through the second quarter of 1958; nearly all of this drop was in automobiles. There is a warning implicit in these changing patterns of spending: just as some industries suffered more than others in the decline, industries will not share equally in the recovery.

One group of industries which seems certain to lag behind others during the upturn is that supplying business with new plant and equipment. Data on orders, spending plans, and new appropriations for capital programs indicate that the decline in this area is likely to continue into 1959. Even where some revival of ordering has occurred, as in machine tools, the orders are still at a low level and usually behind the rate of shipments.

However, growing evidence that the decline in profits has been arrested, as described below, together with general business improvement, should discourage further cutbacks in capital spending and eventually lead to an upturn in this important area of the economy.

Half Year Corporate Earnings

Half year corporate reports indicate that the decline in profits was checked in the second quarter. Reports issued to date by 809 corporations show combined net income after taxes in the second quarter of $2,233 million, a decrease of 28 per cent from the second quarter of 1957 but practically unchanged from the first quarter of 1958. The number of companies reporting second quarter decreases as compared with last year exceeded the increases by two to one, but as compared with the preceding quarter the gains outnumbered the declines by five to four.

For the first half year, combined net income of $4,465 million was 30 per cent under the same period last year, with decreases predominating two to one.

In manufacturing, the total net income of 592 companies in the second quarter was down 34 per cent from a year ago, but about the same as the first quarter of 1958. Industry groups registering improvement this year in the second quarter over the first, although running well below 1957 levels, include tires, paper, chemicals, cement-glass-stone, steel, electrical equipment, and machinery. For food products and tobacco the group totals show gains in both comparisons.

Exceptions to the general pattern of gains over the first quarter include the petroleum refiners, which experienced price weakness, and some of

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR

(In Thousands of Dollars)

No. of Cos.	Industry Groups	Reported Net Income Second Qr. 1957	First Qr. 1958	Second Qr. 1958	% Change from Second Qr. 1957	First Qr. 1958†	Reported Net Income First Half Year 1957	1958	Per Cent Change
47	Food products and beverages	$ 83,820	$ 75,060	$ 84,418	+ 1	+12	$ 157,302	$ 159,474	+ 1
11	Tobacco products	45,213	47,289	55,751	+23	+18	81,058	103,040	+27
28	Textiles and apparel	15,346	10,440	8,472	—45	—19	35,769	18,912	—47
8	Tires, rubber products	19,717	12,529	15,373	—22	+23	41,900	27,899	—33
29	Paper and allied products	48,116	37,231	39,152	—19	+ 5	96,726	76,385	—21
32	Chemical products	174,991	111,418	123,810	—30	+11	347,494	234,729	—32
27	Drugs, soap, cosmetics	53,933	65,887	56,308	+ 4	—15	116,654	122,197	+ 5
35	Petroleum prod. and refining	697,903	522,035	443,666	—36	—15	1,456,216	965,704	—34
52	Cement, glass, and stone	101,760	45,951	83,315	—18	+81	178,098	129,273	—27
34	Iron and steel	311,526	130,654	173,881	—44	+33	633,256	304,533	—52
27	Electrical equip., radio & tv	101,882	81,988	88,304	—13	+ 8	209,804	170,294	—19
44	Machinery	87,562	55,664	70,376	—20	+26	168,143	126,038	—25
109	Other metal products	193,807	121,245	130,907	—32	+ 8	388,604	252,147	—35
32	Automobiles and parts	369,223	214,021	146,107	—60	—32	814,851	360,129	—56
28	Other transportation equip.	60,238	45,276	37,317	—38	—18	112,686	82,593	—27
49	Misc. manufacturing	73,555	47,871	62,534	—15	+31	133,531	110,406	—17
592	Total manufacturing	2,438,592	1,624,559	1,619,186	—34	—	4,972,092	3,243,753	—35
24	Mining and quarrying	40,919	25,642	22,355	—45	—13	81,473	47,997	—41
33	Trade (retail and wholesale)	29,632	28,076	30,882	+ 4	+10	58,526	58,956	+ 1
20	Service and amusement	16,815	13,395	14,571	—13	+ 9	31,132	27,985	—10
53	Railroads	167,242	86,644	90,681	—46	+—	324,150	127,325	—61
84	Electric power, gas, etc.	199,518	279,889	212,008	+ 6	—24	459,814	491,896	+ 7
3	Telephone and telegraph	228,473	223,024	243,580	+ 9	+ 9	446,817	466,604	+ 4
809	Total	$3,116,191	$2,231,229	$2,233,263	—28	+—	$6,374,004	$4,464,516	—30

† Increases or decreases of under 1% or over 100% not computed.

the major automobile producers, which curtailed production sharply to match lower demand. Excluding those two important industry groups, quarterly net income this year of the other manufacturing companies reporting rose 16 per cent.

The table gives the changes by industry groups. In lines other than manufacturing there was continued year-to-year growth in both operating revenues and net earnings of electric, gas, and telephone utilities, whereas declines were experienced by most railroads.

Changes in Sales and Costs

The fact that over half of the reporting manufacturing companies were able this year to increase their earnings from the first to second quarters reflects a wide variety of favorable factors revealed by the figures or commented upon in the corporate reports. In some cases the improvement was based upon an expansion in dollar sales billed, which represented – particularly in the case of consumer nondurable goods producers – a continuation of their long-term growth despite the general business recession. In other cases increased sales came from special selling drives, or from the introduction of new and better products. In still other instances the increase in sales between the first and second quarters could be attributed to the usual seasonal rise that occurs in the demand for products such as building materials and equipment and construction machinery.

Even where second quarter sales did not increase over the first quarter, some companies were able to better their net earnings – as a result of new plant and equipment bringing about a lowering of production costs, or else through programs by management to reduce operating and overhead expenses. A minority of companies were able, through bigger sales or lower costs, to achieve second quarter earnings exceeding even those of a year ago – in contrast with the generally downward trend.

Where second quarter earnings were lower, as compared with either the preceding quarter or with a year ago, the most frequently mentioned causes were slower sales and high, inflexible costs. In some cases earnings declined in the face of increased sales. Many companies cited such factors as higher depreciation charges, research expenditures, unseasonably cool or wet weather, forced reductions in selling prices, intensified competition, foreign imports, obsolescence of older products, strike interruptions, and cutbacks of government contracts.

The automobile companies' suppliers were affected by the curtailment in both passenger car and truck production this year. Most steel companies, operating at much lower rates than last year, enjoyed some pickup in demand during the second quarter, but during July had to pay a wage increase without having any compensating advance in selling prices. Petroleum company earnings suffered this year by comparison with the temporary boom in the first half of 1957 brought about by the Suez closing, as well as from the downward drift of product prices, although such prices recently have firmed as heavy demand continues and excess inventories are worked lower.

The over-all effect of these mixed changes for all the manufacturing companies reporting sales figures for the half year was a combined sales total 13 per cent under that for the first half of 1957. The much sharper drop in net income already noted, amounting to 35 per cent, was the usual consequence of shrinking volume and squeezed profit margins. For the group as a whole, the average net profit per dollar of sales was narrowed from 7.0 to 5.2 per cent.

Dividends More Conservative

Publicly reported cash dividend payments during the first half year were down less than 1 per cent from a year earlier, as reported by the U.S. Department of Commerce, against a rise of 2 per cent in the year 1957 over '56, and 8 per cent in 1956 over '55. With corporate earnings off substantially from last year, the maintenance of the flow of dividends indicates a sharp drop in the income retained to finance growth.

Some companies have continued to pay regular dividends even though not earned, or earned by only small margins, in hopes that a business pickup will warrant maintaining the same rates. If this recovery should not occur, further dividend cuts would be expected. The leveling off in the earnings decline in the second quarter, together with the upturn in key business indicators, should tend to encourage concerns which can afford to do so to avoid disturbing regular rates pending further clarification of the outlook.

Shakeout in Bonds

Since the Treasury's June 15 refunding, which was accomplished on the best terms since 1954, the U.S. bond market has developed acute weakness. The initial price declines stemmed from newspaper reports, June 19, that the Federal Reserve did not want to risk an excessive ballooning of credit and, in light of improvement in key business barometers, was moderating its easy money operations. Heavy unloading by speculators ensued.

On July 14 the bond market felt another jolt from developments in the Middle East, stirring fears of a burst of public and private spending and still bigger federal deficits. Fresh stimulus was given to inflationary psychology – the idea, most simply stated, that stocks are better than bonds.

Meanwhile, there was a pronounced weakening of investor interest in buying bonds at high prices and low yields. Reflecting in part government programs to stimulate homebuilding, opportunities for mortgage investments have increased. Disclosures that the federal deficit for fiscal '59, figured at $8 billion in April, now looks closer to $12 billion, drew attention to the prospective over-supply of Treasury new security offerings. The improving tenor of business news during July bolstered anticipations of stronger business credit demands in the fall and a shift in Federal Reserve policy toward restraint on bank lending resources.

This was a radical change from June. Speculation for the rise in bond prices then reached its zenith, actuated by expectations that the Federal Reserve would pump out so much more money that banks, for lack of adequate other loan and investment opportunities, would pay fancy prices for bonds in order to realize some return on idle funds. It was only when substantial liquidation began that it became clear how large a speculative interest had been attracted to the bond market. Total security loans of the weekly reporting member banks stood at $5.1 billion on June 18, up $1.9 billion in a year and highest since 1946. As of July 23, the figure had dropped back to $3.8 billion.

A Vulnerable Situation

The high level of reporting bank security loans was rather largely explained by the fact that legitimate bond dealers held swollen inventories, including the new Treasury offerings, for later resale. But a greater menace to market stability was a weak structure of unregulated, unreported, and weakly margined security loans arranged outside the banks.

The situation was reminiscent of the problem of "brokers' loans for the account of others" in the heyday of the 1929 stock market boom. As in that case, the lenders most commonly were business corporations though the collateral this time was U.S. bonds (exempt from margin regulation) and the borrowings were handled in the legal form of "buy-back" or "repurchase" agreements. The lender "bought" U.S. bonds subject to the borrower's agreement to take them back at a price that provided a stipulated rate of interest for a short (though sometimes indefinite) period of time. When the bond market weakened, the lender demanded that the borrower either put up margin or take back the securities. The over-extended speculator had no choice but to sell the securities.

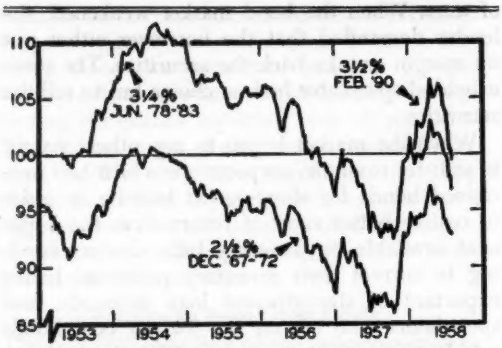
When the market began to sag, others sought to sell: for example, corporations which had purchased bonds for short-period holding in order to realize better rates of return than the 1 per cent available on Treasury bills; dealers needing to correct their inventory positions; banks expectant of strengthened loan demands; and speculators who (as on the 3½ per cent bonds sold last February) gave up waiting for the lapse of six months for long term capital gains. The new surge of inflationary psychology, fanning interest in stock investments, also no doubt explains some sales of bonds which had been taken on by temporary investors sitting out a period of uncertainty in the stock market.

The New York Stock Exchange reported that between May 28 and June 25 borrowing against U.S. Government securities by member firms (both for their own and customers' account) rose by $415 million to $957 million, the highest level in the 15 years these figures have been kept. What volume of loans was arranged outside reporting banks and stock exchange firms is not known though the presumption is that speculation in U.S. bonds has been more common this year than at any time since the World War II period when pegs on bonds made profitable speculation a "lead pipe cinch."

Impact on Prices

The new 2⅝s of February 1965, eagerly sought after when they were issued in June, were struck by successive waves of selling pressure. Despite considerable official support, the 2⅝s slipped off from a June high of 100½ to 97 toward the close of July. The 3¼s of 1985, also sold in June, declined from a high of 101½ to 96. Among the longer issues the 3½s of 1990, issued last February, were weakest, dropping from 107 to 99. More seasoned issues generally have held one half to two thirds of their gains since last October. Yields recovered ¼ to ½ per cent, after dropping ¾ to 1¼ per cent from October to April. Thus yields on Treasuries due beyond 10 years moved into a range of 3 to 3½ per cent, compared to the 3⅝ to 4 per cent range prevailing last fall.

Corporate bonds and tax exempts were affected by the shakeout in Treasuries. Yields on new corporate bonds, Aaa-rated basis, rose from an average of 3.61 per cent in June to 3.85 per cent in July. Despite the weakening market, U.S. Steel successfully placed $300 million Aa-



Friday Closing Bid Prices, Selected U.S. Government Bonds
Last Plotting, Thursday, July 31

rated 25-year 4 per cent debentures at 3.97 per cent.

Yields on new tax exempt issues were marked up ⅛ to ¼ per cent from mid-June to the close of July. Prices on unsold balances of issues put out earlier at lower yield levels had to be marked down correspondingly to attract buyers.

Shoring-Up Operations

The Treasury first, and the Federal Reserve later, made purchases in the market to keep price adjustments orderly. The Treasury, in a strong cash position as a result of June tax collections and the cash sale of the 3¼s, entered the market to buy back large quantities of the 2⅝ per cent bonds issued June 15 with a purpose of cushioning the "disturbing effect" on the market of unloading by "temporary holders." On July 9 the Treasury revealed that it had bought back $589.5 million of the 2⅝s, $456 million for retirement and $133.5 million for government trust fund investment accounts.

In view of conditions in the bond market, the Treasury offered only one-year certificates on its $16.3 billion refunding of 4 per cent certificates due August 1 and 2¼ and 2⅜ per cent bonds due September 15 and confined its $3½ billion August 6 cash borrowing to tax anticipation certificates due March 24, 1959. The Treasury put a 1⅝ per cent rate on its offer of refunding certificates, against 1¼ per cent on 11-month certificates in June, but failed to evoke broad investment interest. Many holders of the maturing obligations either needed their money for September taxes or preferred to await better opportunities to employ their funds. Reflecting preferences for liquidity, U.S. Treasury bills meanwhile were in good demand at yields of 1 per cent and less.

Federal Reserve Support

The Federal Reserve authorities became concerned over the apparent demoralization of the bond market, particularly at a time when the Treasury has to finance its largest peacetime deficit. They suspended for the time being their five year old policy of avoiding direct support of Treasury new security issues and of conducting open market operations in "bills only." Just before the market closed July 18, the Federal Reserve Bank of New York tersely announced:

> In view of conditions in the U.S. Government securities market, the Federal Open Market Committee has instructed the manager of the open market account to purchase Government securities in addition to short-term Government securities.

To avoid an exhausting drain on Treasury cash balances from needs to pay off maturing certificates and bonds, the Federal Reserve authorities bought no less than $1,090 million of the new 1⅝s on a when-issued basis for delivery August 1 – thus inducing exchanges by people unwilling to hold the new obligations.

The authorities also bought $110 million of the maturing bonds for exchange into the new certificates. Nevertheless, as the table shows, there was left unexchanged $2.8 billion maturing certificates and bonds requiring redemption at maturity. This was 29.7 per cent of the $9.3 billion maturities held outside the Federal Reserve. If the when-issued sales of 1⅝s to the Federal Reserve are counted, public holders demanded cash for no less than 42 per cent of their holdings.

Results of Treasury Refunding Offer of $16.3 Billion
1⅝% Certificates due 8/1/59
(In millions of dollars)

	Federal Reserve	Public	Total
Holdings of maturing obligations	$6,943	$9,321	$16,264
"Rights" purchases (+) or sales (—) 7/21-23/58	+110	—110	——
1⅝s when-issued purchases (+) or sales (—) 7/21-23/58	+1,090	—1,090	——
Redeemed for cash	——	—2,770	—2,770
Takings of new 1⅝s	$8,143	$5,351	$13,494

The departure of the Federal Reserve from its "bills only" policy involved moderate purchases of Treasury bonds beyond the herculean direct support of the refunding.

Federal Reserve Purchases (+) and Sales (—) of Treasury Certificates, Notes and Bonds, 1953 - 58

Calendar Year	Certificates	Notes	Bonds	Total
1953	—100	—510*	— 25	—635*
1954	—	—	—	—
1955	+167	—	—	+167
1956	—	—	—	—
1957	— 71	— 83	—	—154
7/18-8/1/58	+1,090	+ 10	+165†	+1,265†

*Including sale of $500 million 2⅛% notes on November 9, 1953 to U.S. Treasury which retired them in advance of maturity to keep within the public debt limit.

†Including $110 million maturing bond "rights" for exchange into 1⅝% certificates.

The massive Federal Reserve purchases, not to mention the attrition on the August refunding, threatened to create on August 1, delivery date

for the 1⅝s, the largest surplus of funds in the money market since World War II.

In this situation the Treasury offering of $3.5 billion 1½ per cent tax anticipation certificates was successfully marketed. Nevertheless, investors remained cautious, and tended to interpret the extent of the Federal Reserve's intervention as a sign of the market's weakness rather than as a signal that the authorities would throw discretion to the winds and attempt to maintain easy money indefinitely.

What To Do

The Congress and Administration have chosen to provide stimulus to business in the recession by increased federal expenditures of almost all types. This approach, more attractive politically than providing stimulus to enterprise by tax reforms, has been pursued with such enthusiasm that the President had to confess on July 2 that there was no prospect of regaining a balanced budget for at least two years.

No one can say how big a deficit the President will forecast for fiscal 1960 in his budget message next January. But closer at hand there is the problem of finding buyers for $10 or $12 billion U.S. Government securities to finance the fiscal '59 deficit in the face of improving business news and a prospect of strengthening private credit demands. In addition to raising new money, and retaining a market for $22 billion 91-day bills, the Treasury will have to refinance $46.1 billion of marketable certificates, notes and bonds maturing in the next twelve months.

What the Federal Reserve has done is by way of an emergency stopgap, which gains some time. But financing governmental deficits through banks of issue is a hazardous business. It raises the spectre of uncontrolled inflation. As we can see from foreign experiences, it can create circumstances in which government bonds can be made salable only if they are tied to cost of living indexes or the price of gold. The unfortunate aspect of the Federal Reserve's massive intervention is that it gives encouragement to inflationary psychology.

The Canadian Plan

A sounder and more enduring solution has been found by our young and imaginative neighbor to the north, Canada. Facing the problem of a deficit, a heavy concentration of early maturities, and a weakening bond market, the Canadian Government, with the wholehearted support of the entire commercial and investment banking community, on July 14 launched a huge refunding involving about 45 per cent of the $14 billion Canadian national debt.

Holders of $6.4 billion 3 per cent Victory bonds issued during World War II and due from 1959 to 1966 were offered four noncallable securities ranging in term from 3¼ to 25 years with no investor permitted to exchange for a maturity shorter than he already held. The bonds offered in exchange (with cash bonuses ranging up to $19.90 per $1,000 as additional bait) are 4½s due September 1983, 4¼s due September 1972, 3¾s due September 1965 and 3s due in December 1961. The new issues have attracted a broad public interest, especially the 4½s, the most attractive rate offered on Dominion Government bonds since 1932 and one that looks good to conservative investors even in an age of creeping inflation.

The Canadian plan accomplishes at one fell swoop what Secretary of the Treasury Robert B. Anderson has been attempting to work out slowly, over an extended period of time. The beauty of it is that the Bank of Canada is relieved from pressure to help the Government with its financing problems.

This sort of step is one we should be considering.

The Core Problem

But most essential is getting federal government expenditures and financial commitments of every type under control. It is not fair to ask anyone to buy bonds of a government which seems to be embarked on deficits as a way of life.

As President Grover Cleveland wisely stated in his last annual message to Congress, in 1896: "The way to perplexing extravagance is easy but a return to frugality is difficult."

Yet the task, in the end, cannot be escaped. National strength and solvency – the preservation of free institutions and trust in government – depend upon facing fiscal facts.

Union Power and the Public Interest

Public concern over the activities and power of labor unions has seldom been higher. Labor has been making big news and hardly a day has passed without some development taking over a prominent position on page one of the nation's newspapers.

In the Congress there have been the disclosures by the McClellan Committee of labor union corruption and racketeering as well as the debate over the inadequacies of the Kennedy-Ives labor reform bill. There has been the proposal by Teamster President James Hoffa for a super transport union (rejected by the Brotherhood of Locomotive Engineers and frowned on by AFL-CIO President George Meany) involving 3½ million land, sea, and air workers. Meanwhile

the auto industry, suffering its worst year in a decade, awaits terms upon which it will be permitted to hire men to build 1959 models.

Right-to-work laws promise to be important issues in elections this fall in at least five states – California, Colorado, Idaho, Washington, and Kansas. These laws are intended to protect the ability of men and women to hold jobs without having to pay a union for the privilege. The National Farm Bureau Federation has urged Congress to pass a federal right-to-work law as the best means of combating labor union corruption. On the other hand, organized labor has attacked such laws as "union busting," claiming they would "divide and destroy" labor and take away "a decent standard of living and humane working conditions."

Debating teams of more than 1,000 colleges and universities chose right-to-work as the public issue topic in the past school year. The issue is an excellent one for searching debate. Do we want to protect ancient and dearly bought freedoms of the individual? Should powers tantamount to taxation be vested in private associations which may be run by small cliques? Can rights to property be preserved if rights to work are denied? Can the value of money be protected without curbing union monopoly power to force up wages? Can the nation safely allow union leaders to hold and exercise power to shut down the economy? On this last question, former President Truman, no enemy of labor, answered decidedly in the negative when a rail strike threatened to cripple the nation in 1946. Mr. Truman asked Congress for authority to draft the rail workers into military service in order to get the trains rolling again.

More and more thoughtful people – including top labor mediators, educators, and "liberal intellectuals" whose sympathies are generally with labor leaders – have become concerned with abuses of organized labor's power. For example, Clark Kerr, president of the University of California, in a pamphlet entitled *Unions and Union Leaders of Their Own Choosing* issued by the Fund for the Republic, expresses fears that unions may be taking too much freedom from the worker. In the April issue of *The Progressive,* Kermit Eby, professor of social sciences at the University of Chicago who in 1948 was director of education and research for the CIO, concludes: "Unions are failing at the point of the strongest claim for their existence: respect for human dignity."

No Longer the Underdog

As Edward H. Chamberlin, professor of political economy at Harvard, noted not long ago in his thoughtful pamphlet, *The Economic Analysis of Labor Union Power* for the American Enterprise Association, we ought to abandon the cliches of "pro-labor" and "anti-labor":

> . . . unions, like business corporations, are "here to stay." But also, like business corporations, they can be subjected to social control.

The rise of union power dates from the Great Depression of the 1930's and the passage of the Norris-La Guardia Act of 1932 and the Wagner Act of 1935. The former prohibited the federal courts from enjoining economically coercive activities by labor unions, and the latter outlawed coercive activity by employers. Before that, as a general rule, strong unions were limited to highly skilled trades. The broad mass of industrial workers and common laborers were unorganized and without ability to bargain collectively. Many employers fought the rights of their employes to organize. Gradually public policy asserted that employes generally should be permitted and even encouraged to join unions and bargain collectively, and under Section 7 (a) of the National Industrial Recovery Act of 1933 union membership mushroomed.

From the comparatively weak position of labor a generation or so ago, today the picture is radically changed. The power pendulum has swung the other way.

Membership in unions has swelled from less than three million in 1933 to more than 17 million today – a potent political force even without counting union members' families, which push the total, directly or indirectly involved in unions, to some 30 to 40 million of voting age. The National Industrial Conference Board estimated last December that unions collect a minimum of $620 million a year in dues. Employe pension funds run into the billions. Union leaders have learned to know and enjoy superior living standards formerly reserved to successful men in business, the arts, science, and politics. In fact union operation has become a relatively unregulated type of big business.

More serious is the fact that labor unions have immunities under the law which give them special privileges.

Donald R. Richberg, legal adviser to unions in the 1920's and head of the NRA in New Deal days, summed up the changed position of labor unions in his recent book, *Labor Union Monopoly:*

> Fifty years ago the picture of the labor union as a weak idealistic organization of downtrodden workers struggling against an oppressive concentration of property power was often accurate. Any such picture of an established union today is not merely ridiculous; it is wilfully or ignorantly untruthful.

Monopoly Power

Roscoe Pound, former dean of the Harvard Law School, last year conducted a searching study, entitled the *Legal Immunities of Labor Unions,* for the American Enterprise Association. He found that unions and their members and officials have privileges and immunities to:

> . . . commit wrongs to person and property, to interfere with the use of highways, to break contracts, to deprive individuals of the means of earning a livelihood, to control the activities of the individual workers and their local organizations by national organizations centrally and arbitrarily administered beyond the reach of state laws, and to misuse trust funds — things which no one else can do with impunity.
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> The labor leader and labor union now stand where the king and government and land owner . . . stood at common law.

The biggest industrial enterprises operate under the constant restraints of the competitive market, requiring the offering of goods and services which will please the public. Entering into price-fixing agreements or otherwise trying to blunt the sharp thrust of competition is denied businessmen — and rightfully so — by antitrust laws.

Labor unions, however, are exempt from such legal restraints. They are free to enter into nationwide combinations for the purpose of fixing prices and conditions of labor that all businesses — large and small — must meet.

The practical effect of this exemption was pointed up by Donald J. Hardenbrook, vice president of Union Bag-Camp Paper Corporation, before a Senate Labor and Public Welfare subcommittee in May:

> Unions freely engage in activities for which businessmen would be promptly indicted, tried and convicted under the antitrust laws. These include, for example, boycotts and agreements to boycott, restrictions on production, restraints on competition such as limiting supply, dividing territories and allocating markets, and suppression of technological improvements.
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> Where coercive monopoly power is strong, no employer, no matter what his size or resources, can stand against it; those who try often sign the death warrant for their businesses.

Mr. Richberg, in his book mentioned earlier, summed up the privileged legal position of labor unions in these words:

> There is grim humor in the constant complaint of the unions against alleged business monopolies, when the only widespread, long-standing and effective monopolies in the business world are those maintained and constantly expanded by labor unions. Their legal exemption from prosecution, combined with a legal expenditure of vast sums of money and an illegal use of physical violence and terrorism, creates for them a monopolistic power which no business combination could possibly exercise.

It is just as natural that trade unions should resist being brought under legal controls as it was that corporations resisted antitrust statutes. But the broad public interest is, or should be, paramount.

Wage Inflation

Professor Sumner H. Slichter of Harvard has been most influential in developing public awareness of the influence of trade union power on the price level. For more than 10 years he has been successfully forecasting a 2 to 3 per cent a year increase in prices. He built this forecast on two main points:

1. Labor unions will make full use of the bargaining powers that full employment confers on them to push up wages faster than the gains in labor productivity.

2. A policy of deliberately creating unemployment to hold down wages is not feasible. The large labor unions would demand that everyone connected with the policy of creating unemployment be removed from office. Labor would drive hard for the election of an easy money Congress, and, helped by the anger of the public toward deliberately created unemployment, there is little doubt that labor would be successful.

Professor Slichter might well have added to his analysis an observation that most leaders of organized labor, while critical of advancing prices, constantly advocate cheap credit and bigger government spending which create the market conditions in which industry can advance prices and finance higher labor costs. But perhaps this is implied under point No. 2.

Professor Slichter rejects the idea that creeping inflation will ultimately speed up and precipitate a "bust." He cites three restraining influences — (1) the role of competition in keeping price advances close to increases in costs; (2) the role of technological progress, and the risks involved in it, in holding back anticipatory equipment and materials purchases; and (3) the role of monetary policy in blocking the creation of debt for purposes of taking advantage of anticipated declines in the purchasing power of the dollar.

We can see how his theory is presently working out. Restraining influences came into play in 1957 to compel an economic slowdown. The International Ladies Garment Workers Union, in the face of the most severe business recession since 1938, demanded and got a substantial wage settlement from employers. But some other unions, recognizing the difficulties of employers, have been willing to go along without further pay increases — as in textiles. Still others, includ-

ing the rubber and chemical workers, have accepted moderate adjustments. Thus, it may be fair to conclude, rising unemployment and falling business profits are having some retarding effect upon the inflation creep. But meanwhile, in accordance with Professor Slichter's theory, we have an "easy money Congress" building up public expenditures and the federal deficit for the purpose of creating more jobs, but with the probable result of giving creeping inflation another lease on life.

Most perilous has been the tendency of the unions to demand cost-of-living escalator clauses in wage contracts and automatic so-called productivity increases in pay for years ahead, not to mention growing "fringe benefits" which, while not adding anything to the pay envelope, add to the burden of costs on the employer. Contracts such as these may insulate workers affected from the pains of inflation and improve their well-being. But the cost is shouldered by the "forgotten man," the unseen, unorganized millions who lack the power to dictate the cut they shall have out of the national production.

Lemuel R. Boulware, vice president of General Electric who for a decade was in charge of that company's labor relations, assessed the situation in a speech in Phoenix, Arizona last May:

> We have inflation not just from the wage increases in excess of 2% a year but also from the inflationary measures union officials have the power to press on government. Too many union officials *like* inflation – mistakenly *want* inflation – regardless of what they say. It makes them look useful, and the dedicated socialists among them know inflation is quietly the most brutal socializer of them all.
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> We have the corrupting of businessmen – who should be moral leaders. Collusion in compulsory membership, rigged markets, and other serious immoral or illegal acts are too often required as the price of survival in full view of government officials who do not dare try to enforce the law.

Another aspect is the tendency for U.S. goods to be priced out of overseas and even domestic markets. This is true for a variety of U.S.-made items – from glass and textiles to machine tools and steel mill products.

A classic example is what has happened in the automobile industry. Despite rising levels of prosperity abroad, U.S. exports of autos have been declining since the end of 1955. At the same time, sales here of low-priced, economical foreign cars have been making new records, year after year.

Compulsory Unionism

In addition to exemption from antitrust laws, another major source of union power is compulsory union membership. This means that an employe must be a union member and keep up his membership if he wishes to keep a job – and in some cases even to get one.

Professor Sylvester Petro, of New York University Law School, defined four different forms of compulsory unionism in his 1957 book, *The Labor Policy of the Free Society:* the "closed shop," which means that a man may not secure employment unless he already belongs to a union; the "union shop," which permits an employer to hire a man before he belongs to a union but which compels the employe thereafter to join the union if he wishes to remain employed; "maintenance of membership," according to which no employe is compelled to join a union, but if he chooses to join is required to remain a member for the duration of the collective agreement; and finally, "preferential hiring," an arrangement whereby the employer agrees to give first preference in employment to union men.

Professor Petro finds that some economic coercion of employe choice exists in even the mildest form of compulsory unionism – maintenance of membership. "In the most stringent forms, the closed shop and the union shop, the economic coercion is irresistible," he adds.

Contract clauses which require membership in a union as a condition of employment are the reverse of the old "yellow-dog" contracts, in which a worker could not get a job unless he agreed not to join a union.

Both kinds of contracts infringe on individual liberty. "Yellow-dog" contracts were outlawed because they were a clear case of economic coercion by the employer. Labor unions, however, practice the same kind of coercion with closed shop and union shop contracts.

The Right to Work

Right-to-work laws, in effect in 18 states, prohibit any requirement of union membership as a condition of employment. They have been a major target of organized labor for many years. The big surge of right-to-work laws came in 1947 (11 states enacted them), the same year the Taft-Hartley Law was passed and the year after the nation suffered the worst rash of strike shutdowns in its history.

It is a curious thing that many who profess to be "liberals" attack the rights of individuals to choose for themselves whether or not they wish to join unions. For example, Mrs. Franklin D. Roosevelt and former Senator Herbert Lehman last month formed a national committee to oppose right-to-work legislation as "anti-labor."

Further opposition to such laws was voiced by selected clergymen of the Roman Catholic, Protestant, and Jewish faiths before a June AFL-CIO conference in New York. However, if it were left to voters nationwide to decide whether the states should have right-to-work laws or not, there are indications that the odds would favor widespread adoption. A coast-to-coast survey by the American Institute of Public Opinion (Gallup Poll) last August found that more than six out of every ten voters said they would vote for such a law, while 27 per cent said they would vote against it. A more recent indication of worker disenchantment with the practices of some unions can be found in complaints filed with the National Labor Relations Board by individual workers concerning unfair practices of unions. These complaints reportedly are running at double the rate of last year.

The AFL-CIO, in an analysis of right-to-work laws in its January 1956 *Economic Review*, commented:

> The open shop "right-to-work" propagandists always refer to liberty, justice, and free choice which union-security provisions supposedly take away from workers. But underlying their misleading declarations of high principle is the attempt to undermine and destroy trade unionism.

It can be argued, of course, that workmen should be required to join and pay dues as a price for services rendered by a union in negotiating a wage contract. But this collides with "high principle": not every workman feels that he wants or needs a union to represent him; not every workman feels that services rendered equal the cost; not every workman trusts or respects the union leadership; not every workman is happy to have his job depend on requirements imposed to keep his union membership in good standing, particularly when these activities may include violations of law and disrespect for the rights of others. The issue cuts deep; without the right to work there can be no means of livelihood.

Right-to-work laws can "undermine and destroy trade unionism" only in so far as a union leadership has lost the confidence of its membership. Thus the arguments quoted above assume the form of a confession that unions cannot survive without compulsion. The fact is that freedom not to join affords one of the easiest checks on a union leadership that is bad and unresponsive to the will of the membership.

Mandatory union membership makes a union the only legal private organization that is given the ability to succeed through compulsion. It runs straight against the grain of traditional concepts of freedom and liberty. In this regard the statements of two labor leaders — one British and one American — are highly significant.

The first was made by Charles Geddes, chairman of the British Trade Union Congress and was carried in the February 1956 issue of *Challenge*, published by the New York University Institute of Economic Affairs:

> I do not believe the trade union movement in Great Britain can live for very much longer on the basis of compulsion . . . Must people belong to us or starve, whether they like our policies or not? . . . I believe the trade union card is an honor to be conferred, not a badge which signifies that you have got to do something whether you like it or not. We want the right to exclude people from our union if necessary, and we cannot do that on the basis of "belong or starve."

The second was made by Samuel Gompers in his final presidential address on the principles of AFL organization at El Paso, Texas in 1924:

> Men and women of our American trade union movement, I feel that I have earned the right to talk plainly with you. . . . I want to urge devotion to the fundamentals of human liberty — the principles of voluntarism. No lasting gain has ever come from compulsion. If we seek to force, we but tear apart that which, united, is invincible.

The Central Issue

No one disputes the right of workers to bargain with employers as a group or the right of workers to strike. The real point of concern was aptly summed up not long ago by Dr. Leo Wolman of Columbia University:

> But when the exercise of these rights is accompanied by conduct which violates accepted standards of behavior with impunity, which enjoys discriminatory rights and privileges before the courts, and which threatens to defeat the working of a free market system by the arbitrary ability to cut off all or most of the supply and flow of important goods and services, our basic American principles of individual freedom and dignity, of equitable treatment, and of the supremacy of the public over purely private interests are endangered.

Professor Chamberlin, in his careful economic analysis of labor unions quoted earlier, concluded:

> There is abundant evidence that unions today do have too much economic power. When this is the case, the public interest requires that steps be taken to reduce it.

Requests for our booklet on the European Common Market mentioned in the July issue have been heavy. It now appears that the publication date will be sometime after August 15. We invite our readers to address their requests to our Public Relations Dept., 55 Wall Street, New York 15, N. Y.

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